SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

No. 715

H. J. BLACKFORD, ET AL.,

Petitioners,

vs.

LEGH R. POWELL, JR., ET AL.,

Respondents

BRIEF FOR PETITIONERS

The petitioners seek a review of the judgment of the Circuit Court of Appeals for the Fourth Circuit affirming October 11, 1945, an order of the District Court for the Eastern District of Virginia, dated April 27, 1945, which denied and dismissed the petition of H. J. Blackford for payment of interest, and on account of principal of Seaboard Air Line Railway Adjustment Mortgage 5% Gold Bonds, outstanding in the hands of the public.

The order of the District Court of April 27, 1945 is to be found on page 4 of the printed record, there was no opinion officially reported. The per curiam opinion of the Circuit Court of Appeals is not officially reported as yet, but will be found on page 337 *et seq.* of the printed record.

Grounds on Which Jurisdiction of the Court Is Invoked

The writ of certiorari is sought pursuant to authority of paragraph 347 (a) Title 28, U. S. C. A. (Judicial Code, Section 240, amended).

The grounds are two in number:

(a) That a rule or principle of law growing out of and established by the decisions of this Court, *i. e.* the rule of full and absolute priority for prior claims as first found in this Court's opinion in the case of *Northern Pacific RR. Co.* v. *Boyd*, 228 U. S. 481, 57 L. Ed. 931, and subsequenty approved and made absolute, rather than relative, in *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 530, 85 L. Ed. 996, 61 S. Ct. 675. "That is to say, senior claims first receive securities of a worth sufficient to cover their face and interest before junior claims receive anything", as expressed in the late case of *Ecker* v. *Western Pacific RR. Corp.*, 318 U. S. 448, 87 L. Ed. 892; and further affirmed in *Institutional Investors* v. *Chicago, M., St. P. and Pacific RR. Co.*, 318 U. S. 523, 87 L. Ed. 960, was invoked to deny to the Adjustment Mortgage 5% Gold Bonds of the Seaboard Air Line Railway the right to participate in any way in the distribution of the assets of the Railway Company in receivership or the securities of the new company formed to take over and succeed to the property of the old Railway Company (248, class 19, pages 250 and 251; also 5 sub par. (b) of Order and Decree of April 27, 1945).

In the application of this rule or principle of law established by the decisions of this Court, the District Court caused an injustice to be done the Adjustment Bondholders through the misapplication of this Court's rule or principle of law by failing to recognize that the prior claim of the Refunding Bonds over the Adjustment bonds and also over the lien, if any, of the First and Consolidated Sixes was not satisfied in accordance with the rule as to its prior claim

but, the prior claim of the Refunding bonds was *compromised* (41) by an agreement with the junior claim of the First and Consolidated 6% bonds and thereby the Refunding bonds prior claim took in accordance with the *compromise agreement* and not in accordance with the rule or principle of law as established by this Court of full or absolute payment to the prior lien or claim of the Refunding bonds over the claim or lien, if any, of the First and Consolidated bonds (20, 23, 37, 40 and 41).

A further wrong was perpetrated upon the Adjustment bonds by reason of the compromise agreement between the Refunding bondholders committee and the committee for the First and Consolidated bonds in that the Adjustment Mortgage Indenture gave a lien to the Adjustment bonds, which, while subordinate to the lien of the Refunding bonds, was prior in time and prior in right to the lien, if any, of the First and Consolidated 6% bonds, yet the prior lien of the Refunding and the junior lien, if any, of the First and Consolidated Sixes undertook, through the committees for these two bonds, to settle by *compromise* agreement the conflicting claims without any consideration whatsoever of the claim of the Adjustment bonds whose lien was senior to the lien, if any, of the First and Consolidated 6% bonds (32 and 36) (6 Adjustment Mortgage Indenture covered same property of Seaboard as Refunding mortgage and was dated October 1, 1909, page 294).

That the application of the full or absolute priority rule or principle of law, as established by the decisions of this Court, is a matter of much concern and grave importance to these petitioners and to holders of securities of other railroads now in reorganization must be apparent and of particular interest to this Court in a consent receivership in a Court of Equity. The misapplication of that rule or principle of law is of even more concern to this Court.

(b) These petitioners for the writ of certiorari, in the petition of Blackford filed in the District Court, sought to show that the large earnings of the Seaboard Railway from its operation by the Receivers during the years 1943 and 1944 (3) (although the years 1941, 1942 and 1945 greatly increased these net earnings) are subject to the lien of the Adjustment mortgage and provide a means by which the Adjustment bonds, outstanding in the hands of the public, could be awarded proper recognition by the District Court. But, the lower Court denied any relief to the petitioners below and the Circuit Court of Appeals affirmed in holding there were no funds (341) in the receivers hands subject to the lien of the Adjustment mortgage out of which the payments prayed for could be paid. The Circuit Court of Appeals for the Fourth Circuit thus denied to the Adjustment bondholders the right to share in the assets of the Seaboard Railway arising out of the large net earnings for the War years which are a reality and not the mere forecast of some expert witness, produced by a bondholders group interested in the outcome of their own bond issue in the allocation of securities of the reorganized railroad.

This holding of the Circuit Court of Appeals for the Fourth Circuit cannot be reconciled with the position taken by the Circuit Court of Appeals for the Tenth Circuit and a direct conflict results, for the Tenth Circuit Court of Appeals expressly pointed out in its opinion in the case of the reorganization under Section 77 of the Bankruptcy Act, of the Denver and Rio Grande Western RR. Co. reported in 150 Fed. 2nd, page 28, Advance Sheets, September 3, 1945,

At page 37:

> "The mere fact, however, that cash and current assets are not required to be reflected in the capital structure in the form of capitalized value does not remove them from the picture. They are nevertheless

assets of the corporation which must be taken into account in drawing up a fair and equitable plan of reorganization, and must be distributed in a manner that is fair and equitable to all classes of creditors. The Senior Bondholders were paid in full. They received all the new securities and most of the common stock. Ninety per cent of the General Bondholders' claims were wiped out. They received only a small amount of common stock, ten per cent of their total claims. Adequate operating funds are essential to the operation of a railroad. The Senior Bondholders are entitled to receive in addition to the full amount of their claims, working capital sufficient for proper and efficient operation of the railroad. But anything in excess of what was reasonably necessary for this purpose constituted assets of the insolvent corporation which belonged to the remaining creditors."

"We think it is apparent from the record that there were current assets on hand consisting of cash and securities in excess of what was needed for the efficient operation of the road. As pointed out, the working capital of the debtor had increased from a deficit of $9,727,230 as of December 31, 1935, to a surplus of $12,125,683.50 as of December 31, 1944. While these increased net earnings are due in large part to the war, and may therefore be disregarded in setting up the capitalized structure based upon prospective earnings, we cannot disregard the fact that these huge surpluses actually exist. Their existance is an accomplished fact. * * *"

These are the grounds on which this Court's jurisdiction is invoked to review the judgment of the lower Court.

Statement of Case

The receivership of the Seaboard Air Line Railway Company was instituted December 23, 1940, (314) upon a creditors' bill filed in the District Court for the Eastern District of Virginia. There followed on January 15, 1931,

(36) a suit in Equity by the Trustees of First and Consolidated Mortgage claiming a lien upon all the railroads and property, rights, etc. and earnings and income prior and superior to the claims and liens of the defendants named in the Bill, (294) the Fidelity Trust Company (Baltimore), Trustee under the Adjustment Mortgage Indenture was named one of the defendants. Orders were entered and the cause consolidated with the creditors' suit. (315)

The Trustees under the First Mortgage and the Refunding Mortgage filed their respective bills within two months thereafter. (6) Ancillary proceedings were instituted in the District Court for the Southern District of Florida. The present Receivers, Legh R. Powell, Jr. and Henry W. Anderson were appointed December 31, 1932, upon the resignation of one of the original Receivers and have operated the Seaboard since then.

Not until February 3, 1941, was any further action of foreclosure taken. Then followed a series of actions by seven of the Underlying bonds. December 5, 1942, the last foreclosure was instituted and the same action as to impounding orders (57) and as to Receivers taken. The Trustee under the Adjustment Mortgage Indenture did nothing.

The Seaboard remained in the Equity Court Receivership with nothing done looking to a reorganization until March 4, 1940, when a Special Master appointed by the Courts, commenced hearings for the purpose of formulating a plan of reorganization. (136). The Special Master submitted his report July 20, 1943 (175) with a plan of reorganization in which the Adjustment bonds were denied any value and any right to participate in the assets of the Railroad in reorganization. Exceptions to this Report were filed by certain groups of secured creditors and stockholders and during the hearing on these exceptions in the District Court, on October 29, 1943, Emanuel M.

Cohan with two other bondholders came in and filed exceptions, supposedly on behalf of the Adjustment bonds. (233) The District Court overruled exceptions to the Master's Report and by its order of December 10, 1943, confirmed the Report, as modified. (242)

From the order of December 10, 1943, appeals to the Circuit Court of Appeals for the Fourth Circuit were taken on behalf of different groups of security holders. One of the petitioners herein, Mr. Simpson, pro se, appealed on behalf of the South Bound Railroad Company bonds, an underlying mortgage. The Cohan group, which had appeared in the proceedings as representing Adjustment bonds, entered an appeal, (239) but, by letter dated May 4, 1944, addressed to the Clerk of the District Court, withdrew the appeal. (241) The Circuit Court of Appeals affirmed the lower Court, August 2, 1944, the opinion being reported in 145 Fed. (2d), page 40, under the title, *Badenhausen, et al.* vs. *Guaranty Trust Co., et al.* (*Guaranty Trust Company, et al.* vs. *Seaboard Air Line Railway Company, et al.*)

Chronology of General Mortgages of The Seaboard Air Line Railway Company

First Mortgage 4% bonds, due April 1, 1950, issued under mortgage dated April 14, 1900. A direct first mortgage lien on 243.70 miles of railroad and junior lien on 2174.83. There are various securities and certain equipment covered by the lien. $19,024,320 of this debt is in the hands of public of which $6,256,320 is unpaid interest to January 1, 1943.

Refunding Mortgage 4% bonds, due October 1, 1959, issued under mortgage dated October 1, 1909. A direct first lien on 215.85 miles of railroad, a direct junior lien on all mileage and securities covered by the First Mortgage, a direct junior lien on 192.35 miles of railroad, a junior lien

on 62.77 miles of railroad, and a lien upon various securities. $27,000,000 of First Mortgage 4s are deposited with Refunding Trustee. The Trustee holds various securities and claims against other securities. A lien upon certain equipment. $28,831,000 of this debt is in the hands of the public of which $9,481,500 is unpaid interest to January 1, 1943.

Adjustment Mortgage 5% bonds, due October 1, 1949, issued under mortgage dated October 1, 1909. A lien immediately subordinate to the Refunding Mortgage on all railroad mileage and securities which are subject to the lien of the Refunding Mortgage. All railway and other property thereafter acquired. All profits and other income from the property subject to the lien. $4,708,333 of this debt is in the hands of the public of which $2,208,333 is unpaid interest to January 1, 1943.

First and Consolidated Mortgage 6% bonds, due September 1, 1945, issued under a mortgage and deed of trust dated September 1, 1915, which purports to give a direct first mortgage lien on 408.96 miles of railroad (East Carolina Lines). The Refunding Mortgage Trustee claimed a lien upon this mileage prior to that of Consolidated 6s. There were $65,915,000 of Refunding bonds deposited under this mortgage. A lien of certain equipment and various securities. $107,875,320 is in the hands of the public of which $45,877,820 is unpaid interest to January 1, 1943.

The Seaboard Air Line Rwy Co. came to be the successor in interest by merger and consolidation of S. A. L. Rwy. with the Carolina, Atlantic and Western Rwy. on or about 15 Nov. 1915, (24, 25)

Argument

The argument will follow as to the issuance of the writ and the authority therefore—then, as to the errors in the lower Courts in denying to the Adjustment bondholders any relief.

That the Court, in the exercise of its judicial discretion, may issue the writ of certiorari to review the judgment of the lower Court is established by numerous decisions of this Court and to quote from the Courts opinion in a recent reorganization proceeding under the bankruptcy statute: "We granted the petitions for certiorari because of the importance in the administration of the reorganization provisions of the Act of certain principles enunciated by the Circuit Court of Appeals."

Consolidated Rock Products Co. vs. *DuBois* (supra),

This Court granted the writ in the case of
Ecker vs. *Western Pacific R. Corp.* (supra).

to review questions in connection with railroad reorganization and questions of "priorities of liens created by different mortgages and subsidiary issues".

And in the companion cases arising out of the reorganization of the *Chicago, M., St. Paul & P. R. R. Co.*, (Supra).

In the case at bar, the reorganization of the Seaboard did not come under the provisions of Section 77 of the Bankruptcy Act but continued under the Equity Court consent receivership to be reorganized notwithstanding the passage of that Act in 1933 and its subsequent amendments. This Court said of the equity receiverships: "These were cumbersome, costly and privately managed," in the *Western Pacific R. Corp.* case (supra).

This Court granted the writ of certiorari in: *South Chicago Coal and Dock Co.* vs. *Bassett*, 300 U. S. at page 253; 84 L. Ed. at page 734,

"Because of an alleged conflict with a decision of the Court of Appeals of the Fifth Circuit."

It is respectfully submitted that the writ should issue.

As to the errors in the lower Courts?

The Trustee of the Adjustment Mortgage took no action looking to the protection of the interests of its bondholders. In that situation, there was nothing to do other than what these Petitioners did, that is, file their claims in the Receivership proceedings.

"If the mortgage trustee fails to file claims, holders of bonds secured by a mortgage are entitled to file their claims and, further, a provision of the mortgage giving exclusive right to trustee is ineffectual to the extent it is prejudicial to such right of the bondholders." *Blumgart* vs. *St. Louis, San Francisco Railway,* 94 Fed. (2d), page 712.

The right of the bondholder to act is given under the Act. Title 11, U. S. C. A. 205(c) 7 and 13.

As to laches on the part of the Petitioners?

The Petitioners tried to get the Trustee under the Adjustment Mortgage to take action (18) but only succeeded in having the Trustee give the formal notice of default which accelerated the maturity of the principal and made the interest due and payable to date (19).

This Court said the delay of over ten years on the part of Boyd in trying to establish his unsecured claim was not such laches as to bar his suit.

Northern Pacific Rwy. Co. vs. *Boyd,* (supra).

And this Court has said that "failure, long continued, to discover a well known appropriate remedy for a wrong, does not establish laches where there has been due diligence and the defendant has not been prejudiced by the delay."

Southern Pacific Co. vs. *Bogert,* 250 U. S. 483, 63 L. Ed. 1099.

The Petitioners filed their claims as bondholders and took this action, not only for themselves, but for any and all other holders immediately after they found their efforts, to move the Trustee of their bonds to file, were futile.

Perhaps enough has already been said as to the lien of the Adjustment bonds and the lien, if any of the First and Consolidated 6% bonds, but, it might be added, that the Counsel for the Trustee of the Refunding bonds raised the question as to the lien, if any, of the First and Consolidated 6% bonds and if there had been no *compromise* settlement of this question and the First and Consolidated 6% bonds had been relegated to their proper position in the heirarchy of Seaboard securities the Adjustment bonds would have received full payment before the, so called, First and Consolidated 6% bonds were permitted to participate in the allocation of the securities of the new Seaboard.

This would have been the proper application of the rule of this Court arising out of the *Boyd* case (*Northern Pacific R. R.* vs. *Boyd*).

The District Court, even today, has before it the question of distributing $9,334,000.00 to the holders of old securities of the Seaboard. (The Baltimore Sun, 28 Dec. 1945, page 22.)

It is respectfully submitted the Petitioners are entitled to some relief at the hands of this Court.

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Dated, January 4, 1946.